

NOT FOR CITATION

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

STANLEY J. KATZ, et al.,

Petitioners,

v.

ROUND HILL SECURITIES, INC.,
et al.,

Respondents.

No. C 05-1453 PJH

**ORDER GRANTING PETITION TO
CONFIRM ARBITRATION AWARD**

On August 31, 2005, the court heard argument in connection with the petition of Stanley J. Katz, Edwin L. Katz, and First Alliance Management, Inc., to confirm an arbitration award entered in favor of petitioners and against respondents Round Hill Securities, Inc., and First Allied Securities, Inc. Petitioners appeared by their counsel Richard T. White and Thomas P. Whelley II, and respondents appeared by their counsel Michael R. Simmonds. Having read the parties' papers and carefully considered their arguments and the relevant legal authority, and good cause appearing, the court hereby GRANTS the petition to confirm the arbitration award.

INTRODUCTION

Petitioners Stanley J. Katz and Edwin L. Katz ("the Katz brothers") are residents of Dayton, Ohio. Petitioner First Alliance Management, Inc. ("First Alliance"), is an Ohio

1 corporation owned by the Katz brothers, and is registered with the Securities and Exchange
2 Commission as an investment advisor. Respondent Round Hill Securities, Inc. ("Round Hill")
3 is a California corporation and a registered broker-dealer of securities.

4 On March 26, 1998, each of the Katz brothers executed a National Association of
5 Securities Dealers ("NASD") Form U-4 (Uniform Application for Securities Industry
6 Registration or Transfer). Round Hill filed the Form U-4s, which also stated that each of the
7 Katz brothers would be transferring as a broker from Paine Webber on March 27, 1998, with
8 the appropriate regulators. In signing the Form U-4, the Katz brothers agreed to

9 arbitrate any dispute, claim, or controversy that may arise between me and my
10 firm, or a customer, or any other person, that is required to be arbitrated under
11 the rules, constitutions, or by-laws of the organizations indicated in item 10 as
12 may be amended from time to time and that any arbitration award rendered
13 against me may be entered as a judgment in any court of competent
14 jurisdiction.¹

15 On March 27, 1998, the Katz brothers and First Alliance entered into a Registered
16 Representative Agreement ("the Agreement") with Round Hill, whereby Round Hill appointed
17 petitioners independent "Contractors" for Round Hill in the sales of securities to the public.

18 The Agreement, which was drafted by Round Hill, provided in ¶ 8.3 that "any"
19 controversy between the parties "arising out of or relating to this Agreement or the breach
20 thereof" would be submitted to binding arbitration in accordance with the rules of either NASD
21 or the American Arbitration Association ("AAA"), "as the Contractor [i.e., the petitioners
22 herein] may elect." The Agreement provided further that any court – state or federal – having
23 jurisdiction was granted power to enter a judgment on any award resulting from arbitration
24 because the arbitration award resulting from arbitration was to be a final and nonappealable
25 decision on the controversy submitted.

26 In January 2003, a dispute arose between the parties concerning the payment of
27 commissions to the Katz brothers, and management fees to First Alliance. This was a matter
28 "arising out of" the Agreement. Petitioners elected to take the matter to arbitration with the
AAA. An arbitrator was selected and confirmed in September 2003, and the arbitrator held

¹ The only box checked under "item 10" on the Form U-4s was "NASD."

hearings and heard evidence. On April 4, 2005, the arbitrator issued an award in favor of petitioners in the amount of \$306,902, plus \$141,000 in attorneys' fees. On April 8, 2005, petitioners filed the present petition for confirmation of the award.

On May 9, 2005, Round Hill filed an application for an order vacating the arbitration award (in lieu of filing an opposition to the petition). Round Hill asserted that the arbitrator had exceeded his powers because he did not have jurisdiction to hear the Katz brothers' claim, and because the award ordered Round Hill to pay commissions to a non-broker-dealer and non-NASD member (First Alliance), in violation of NASD rules.

In June 2005, Round Hill merged with respondent First Allied Securities, Inc. ("First Allied"), a New York corporation with its principal place of business in San Diego, with First Allied as the surviving entity. After Round Hill and First Allied merged, petitioners filed a supplemental petition to confirm the award, and served First Allied. First Allied then filed a notice of joinder in the application to vacate the award.

DISCUSSION

A. Legal Standard

The Federal Arbitration Act ("FAA") "gives federal courts only limited authority to review arbitration decisions, because broad judicial review would diminish the benefits of arbitration." Lifescan, Inc. v. Premier Diabetic Servs., Inc., 363 F.3d 1010, 1012 (9th Cir. 2004) (citing Kyocera Corp. v. Prudential-Bache Trade Servs., Inc., 341 F.3d 987, 998 (9th Cir. 2003) (en banc)). Under the FAA, if a party seeks a judicial order confirming an arbitration award, "the court must grant such an order unless the award is vacated, modified, or corrected as prescribed in sections 10 and 11 of this title." 9 U.S.C. § 9. Confirmation is required "even in the face of erroneous findings of fact or misinterpretations of law." French v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 784 F.2d 902, 906 (9th Cir. 1986) (citation and quotation omitted).

Section 10 permits vacatur only

(1) where the award was procured by corruption, fraud, or undue means;

(2) where there was evident partiality or corruption in the arbitrators, or either of

1 them;

2 (3) where the arbitrators were guilty of misconduct in refusing to postpone the
3 hearing, upon sufficient cause shown, or in refusing to hear evidence
4 pertinent and material to the controversy; or of any other misbehavior by which the
5 rights of any party have been prejudiced; or

6 (4) where the arbitrators exceeded their powers, or so imperfectly executed
7 them that a mutual, final, and definite award upon the subject matter submitted
8 was not made.

9 U.S.C. § 10(a).

10 The grounds set forth in § 10(a) "afford an extremely limited review authority, a
11 limitation that is designed to preserve due process but not to permit unnecessary public
12 intrusion into private arbitration procedures." Kyocera, 341 F.3d at 997. The "exceeded their
13 powers" provision of § 10(a)(4) allows vacatur only when arbitrators purport to exercise
14 powers that the parties did not intend them to possess or otherwise display a manifest
15 disregard for the law. Id. at 1002. Arbitrators exceed their powers in this regard not when
16 they merely interpret or apply the governing law incorrectly, but when the award is "completely
17 irrational," French, 784 F.2d at 906, or exhibits a "manifest disregard of law," Todd Shipyards
18 Corp. v. Cunard Line, Ltd., 943 F.2d 1056, 1059-60 (9th Cir. 1991). See Kyocera, 341 F.3d
19 at 997.

20 The risk that arbitrators may construe the governing law imperfectly in the course
21 of delivering a decision that attempts in good faith to interpret the relevant law,
22 or may make errors with respect to the evidence on which they base their
23 rulings, is a risk that every party to arbitration assumes, and such legal and
24 factual errors lie far outside the category of conduct embraced by § 10(a)(4).

25 Id. at 1002-03.

26 B. The Parties' Arguments

27 Petitioners assert that the award should be confirmed under § 9 of the FAA. They note
28 that the parties agreed that "any dispute" between Round Hill and a Contractor (the Katz
brothers and First Alliance) "arising out of" the Agreement should be settled by arbitration
pursuant to the rules of either NASD, or AAA – at the election of the Contractors. They
contend that because the arbitration went forward before the AAA, as specified in the
Agreement, and the arbitrator issued the award, the award should now be confirmed. They

1 argue that respondents should not now be permitted to declare a provision in their own
2 agreement invalid.

3 Respondents assert that the award should be vacated because the arbitrator
4 exceeded his powers. Based on the fact that the Katz brothers signed the NASD Form U-4
5 agreeing to arbitrate any disputes under the rules of the NASD, respondents contend that the
6 NASD had exclusive jurisdiction to hear the claims raised by the Katz brothers, and that the
7 arbitrator exceeded his powers by improperly exercising jurisdiction over those claims and by
8 awarding commissions to the Katz brothers. Respondents argue that the Form U-4 requires
9 arbitration of all claims before NASD (not another entity, such as AAA), and that the arbitration
10 provision in the Agreement between petitioners and Round Hill was “superceded as a matter
11 of law” by the arbitration clause in the Form U-4.

12 Respondents contend that the Agreement between Round Hill and petitioners cannot
13 be read to confer jurisdiction contrary to NASD rules. They note that the § 4.2 of the
14 Agreement provides that “[i]n connection with all of Contractor’s activities” under the
15 Agreement, “Contractor shall comply with all rules and regulations of the Securities Act of
16 1933, the Securities Exchange Act of 1934, the Adviser Act, the NASD, SEC and securities
17 laws of the states and all Interpretations thereof, where securities will be offered for sale.”
18 Respondents submit that to the extent that the arbitration provision of the Agreement conflicts
19 with other provisions of the agreement (such as the provision requiring compliance with NASD
20 rules), it must be deemed invalid and unenforceable. They argue that NASD member firms
21 and associated persons cannot simply “agree” to violate the rules and regulations of the
22 NASD, which have been approved by the SEC and which govern them.

23 Petitioners respond that Round Hill was aware of the NASD rules and the contents of
24 the Form U-4 at the time it signed the Agreement with petitioners, and that it agreed to
25 arbitrate before either the NASD or the AAA, with petitioners to make the choice. Petitioners
26 contend that Round Hill has never challenged the basic premise that it is bound to arbitrate the
27 claims brought by petitioners, nor has it challenged the viability of its Registered
28 Representative Agreement, but has instead asserted that the contractual arbitration

1 agreement was superceded by a subsequent agreement, the NASD Form U-4, with its
2 requirement of arbitration under the NASD rules. Petitioners claim, however, that the Katz
3 brothers signed the Form U-4 on March 26, 1998, the day before they signed the Agreement
4 with Round Hill on March 27, 1998. Thus, they assert, the Form U-4 could not have
5 “superceded” the arbitration provision in the Agreement.

6 Petitioners argue further that the respondents’ jurisdictional arguments were waived
7 because they were not timely raised in the AAA arbitration, noting that there was a six-month
8 delay between the filing of the statement of claim in April 2003 and Round Hill’s filing of the
9 motion to dismiss in October 2003. Petitioners assert that during that period, Round Hill
10 actively participated in the AAA proceedings, submitting briefing on the subject of the location
11 of the arbitration, and participating in the choosing of the arbitrator. Petitioners assert that
12 only after completion of these activities did Round Hill file a jurisdictional challenge to the
13 arbitrability of claims by the Katz brothers (but not the claims of First Alliance). Petitioners
14 assert that the failure to timely raise these arguments in the AAA arbitration, and failure to
15 seek a stay of the arbitration in district court, constitute a waiver of the arguments.

16 Respondents contend that Round Hill did not waive the requirement that the dispute be
17 arbitrated before the NASD. They claim there was no substantial delay and that petitioners
18 did not suffer undue prejudice, because after the issue was raised in Round Hill’s motion to
19 dismiss, the Katz brothers continued to press their claims before the AAA for twenty months
20 more, finally obtaining the award that is the subject of this action. Respondents maintain that
21 the Katz brothers knew that Round Hill would eventually seek to vacate any award on that
22 ground, but nonetheless improperly proceeded with the AAA arbitration.

23 Petitioners also dispute respondents’ assertion that the arbitration provision in Form
24 U-4 and the NASD rules require arbitration before the NASD. Petitioners argue that the
25 reference in Form U-4 to “any dispute . . .” that is “required to be arbitrated” under the rules of
26 NASD simply means that there must be an arbitration of any such dispute, but does not mean
27 that the arbitration must be conducted in accordance with the NASD rules or under the
28 auspices of an NASD arbitrator. Respondents, on the other hand, contend that Form U-4

1 should be interpreted as requiring that any dispute, claim, or controversy be arbitrated under
2 the NASD rules.

3 With regard to the NASD rules, petitioners argue that NASD Code of Arbitration Rule
4 10201, which requires arbitration under the NASD rules “at the instance of” an NASD member
5 or person associated with a member against another member or person associated with a
6 member means that the arbitration must be brought with the NASD where one of the parties to
7 the arbitration demands that it be brought with the NASD. Petitioners contend that the NASD
8 is not concerned with members who may agree to arbitrate in another forum.

9 Respondents, on the other hand, contend that the language of Rule 10201 means that
10 except for special claims, “all disputes shall be arbitrated under the [NASD] Code.” However,
11 they omit the four words following that clause – “at the instance of” – and argue that there is no
12 authority for petitioners’ “novel interpretation” of the phrase. Instead, they cite NASD Code of
13 Arbitration Rule 10101, which simply states that the rules in the Code are prescribed and
14 adopted “for the arbitration of any dispute, claim or controversy . . . (b) between or among
15 members and associated persons “

16 Respondents claim that their interpretation is supported by the fact that the NASD
17 recently announced proposed rule changes (still under consideration by the SEC), which
18 include a New Proposed Rule 13200, “Required Arbitration,” stating, “Except as otherwise
19 provided in the Code, a dispute must be arbitrated under the Code if the dispute arises under
20 the business activities of a member or an associated member and is between or among . . .
21 Members and Associated Persons” Respondents contend that the present dispute does
22 not fall under any of the enumerated exceptions, and argue that because the NASD has stated
23 that these proposed rules represent “no substantive change” from the current rules, the court
24 should find that NASD arbitration is required in the present dispute. They also assert that if
25 the Katz brothers’ interpretation of the phrase “at the instance of” were the correct one, then
26 the New Proposed Rule 13200 would constitute a radical change.

27 In a final argument, petitioners contend that in arguing that the arbitration should
28 properly have been brought before the NASD, and that First Alliance cannot arbitrate before

1 the NASD because it is not a member, respondents are attempting to deprive First Alliance of
2 a forum in which to arbitrate its claims against respondents. Petitioners assert that the AAA
3 was the only jurisdiction where all interested parties could obtain relief, as NASD rules do not
4 permit First Alliance (a non-member) to bring its claims to arbitration before the NASD.
5 Petitioners argue that enforcing the award in favor of First Alliance would not violate public
6 policy because there is no clearly defined statutory or other explicit public policy that would be
7 violated by confirming the arbitration award in the present case.

8 In response, respondents contend that while First Alliance was free to submit its claim
9 for arbitration before the AAA, the Katz brothers were not. Respondents also contend that
10 because the arbitrator did not indicate the specific amount awarded to First Alliance, the
11 entire \$306,902 can be viewed as an award of “commissions” to First Alliance. They argue
12 that because it is a violation of NASD rules and regulations for a member firm (such as Round
13 Hill) to pay commissions to a non-member (such as First Alliance), an award that orders
14 Round Hill to pay commissions to a non-NASD-licensed or -registered broker-dealer is
15 therefore a violation of law and a violation of public policy.

16 C. Analysis

17 Proceedings under § 9 of the FAA are intended to be summary, and confirmation can
18 be denied only if an award has been corrected, vacated, or modified in accordance with the
19 FAA. See, e.g., Northrop Corp. v. Triad Int’l Marketing, S.A., 842 F.2d 1154, 1157 & n.7 (9th
20 Cir. 1988); Schwarzer, Tashima & Wagstaffe, Federal Civil Procedure Before Trial (2004)
21 § 16:132. Based on the clear policy favoring confirmation of arbitration awards, the court finds
22 that the petition to confirm the award should be GRANTED. The court finds further that the
23 application to vacate the award should be DENIED, as respondents have not met the high
24 standard for vacating arbitration awards.

25 Respondents have not established that the arbitrator exceeded his powers. Section
26 10(a)(4) of the FAA has been interpreted by the Ninth Circuit as meaning that the award is
27 “completely irrational” or “exhibits a manifest disregard of the law.” Respondents do not argue
28 that the award falls into either of those categories. Arbitrators may also “exceed their powers”

1 where they purport to exercise powers that the parties did not intend them to possess. Here,
2 the Agreement provided that petitioners would be permitted to choose whether they wanted to
3 arbitrate before the AAA or the NASD. There is no question of the arbitrator purporting to
4 exercise powers that the parties did not intend him to have.

5 The court finds that the NASD rules on which respondents rely are ambiguous and far
6 from clear. The court does not agree with respondents that the language in Rule 10201 –
7 “shall be arbitrated under the Code, at the instance of” a member or associated person –
8 simply means “shall be arbitrated under the Code.” The word “instance” as used in the phrase
9 “at the instance of” means “urgent solicitation or insistence.” Black’s Law Dictionary (7th ed.
10 1999) at 800; see also Bryan A. Garner, A Dictionary of Modern Legal Usage (2nd ed.,
11 Oxford Press, 2001), at 454-55. In the court’s view, the requirement that a dispute “shall be
12 arbitrated under the Code at the instance of” a member or associated person appears to be a
13 requirement that the dispute be arbitrated under the NASD Code if a request to arbitrate
14 under the Code is made by a member or associated person. At a bare minimum, the
15 provision is ambiguous.

16 Moreover, the other rules cited by respondents do not compel arbitration under the
17 NASD Code or rules – but rather simply require arbitration of certain issues, without
18 specifying the arbitral body. The court finds nothing in the rules cited by respondents that
19 clearly prohibits parties from agreeing to arbitrate in a forum other than the NASD. The case
20 cited by respondents, Burns v. New York Life Ins. Co., 202 F.3d 616 (2nd Cir. 2000), simply
21 stated (not as part of the holding) that the “relevant ‘rules’ and ‘by-laws’” referenced in Form
22 U-4’s agreement to arbitrate (“I agree to arbitrate any dispute . . . that may arise . . . that is
23 required to be arbitrated under the rules, constitutions, or by-laws of the organizations with
24 which I register”) referred in that case to the NASD Code of Arbitration Procedure. Burns, 202
25 F.3d at 619. However, the Form U-4 agreement does not state that any dispute between
26 NASD members must be arbitrated under the auspices of the NASD, but rather simply that the
27 person signing agrees that he or she will arbitrate any dispute that the NASD rules require to
28 be arbitrated.

1 The court is also not persuaded by respondents' argument with regard to the "New
2 Proposed Rule 13200" and the statement by NASD that none of the proposed new rules
3 represents any substantive change from the old rules. The new rules have not yet been
4 approved, and there is no way of knowing whether they will. A "proposed rule" is not a rule,
5 and provides no basis for finding that the arbitration award should be vacated.

6 Finally, with regard to the claim that the award improperly awards "commissions" to
7 First Alliance because it does not distinguish between the award to the Katz brothers and the
8 award to First Alliance, the court is not persuaded that respondents have articulated a valid
9 basis under the FAA for vacating the award. At the arbitration, the petitioners collectively
10 asserted a total damage claim of \$252,297.54, plus interest, costs, and attorneys' fees, plus
11 "miscellaneous claims" of \$7,329.29. Among the "miscellaneous claims," First Alliance
12 asserted that Round Hill had improperly retained a portion of "management fees" billed to
13 Bear Stearns accounts for the quarter in which First Alliance was terminated. Respondents
14 argue that it is impossible to tell from the award whether any of the \$6,164.29 requested for
15 "management fees" was awarded by the arbitrator, or whether First Alliance was also
16 improperly awarded "commissions."

17 The court is not in a position to know for certain how much of the award was intended to
18 be allocated to First Alliance, as that knowledge lies with the arbitrator. However, Thomas
19 Whelley, counsel for petitioners, who also represented the petitioners at the arbitration,
20 represented to the court at the hearing that Round Hill never requested payment of
21 commissions to First Alliance, that the amount of the final award approximated the total sought
22 by claimants in the arbitration, and that the amount of the management fees sought by First
23 Alliance was such a minor concern that it was not even raised during the arbitration
24 proceeding itself. Thus, the court has no basis to assume that the respondents contemplated
25 or that the arbitrator intended that First Alliance recover any amount in excess of its \$6,164.29
26 in management fees.

27 ///

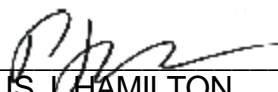
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CONCLUSION

In accordance with the foregoing, the court CONFIRMS the award of the arbitrator. The clerk shall close the file.

IT IS SO ORDERED.

Dated: September 16, 2005


PHYLLIS J. HAMILTON
United States District Judge